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97TH CONGRESS 2d Session } HOUSE OF REPRESENTATIVES { REPORT No. 97-774

COMPLETED

EXTENSION OF THE CREDIT CONTROL ACT

AUGUST 19, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ST GERMAIN, from the Committee on Banking, Finance and Urban Affairs, submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany H.R. 6124]

[Including cost estimate of the Congressional Budget Office]

The Committee on Banking, Finance and Urban Affairs, to whom was referred the bill (H.R. 6124) to reduce interest rates, control inflation, and ensure the availability of credit for productive purposes, and promote economic recovery by extending the Credit Control Act, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

That section 211 of the Credit Control Act (12 U.S.C. 1910), as in effect on the day before the date of the enactment of this Act, is hereby repealed.

SEC. 2. (a) Section 205(a) of the Credit Control Act (12 U.S.C. 1904(a)) is amended to read as follows:

"(a) Whenever the President determines that such action is necessary or appropriate to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession, the President may authorize the Board to regulate and control any or all extensions of credit.".

(b) Section 206 of the Credit Control Act (12 U.S.C. 1905) is amended by redesignating paragraphs (7) through (11) as paragraphs (8) through (12), respectively, and by inserting after paragraph (6) the following:

"(7) prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes.".

SEC. 3. The Credit Control Act (12 U.S.C. 1901 et seq.) is amended by adding at the end thereof the following:

"Sec. 211. Review of financing for corporate acquisitions or mergers

"(a) Without regard to the procedures specified in section 205(a) of this title, the Board is authorized to require any commercial bank which plans to assist in the financing of any part of a corporate acquisition or merger involving more

than $10,000,000 in financing to notify the Board of such proposed financing before a line of credit is extended by such commercial bank.

"(b) The Board may disapprove any proposed financing if the Board determines that the corporate acquisition or merger involved cannot reasonably be expected to produce benefits to the public, such as increased employment, increased competition, or gains in efficiency, which outweigh possible adverse effects, such as the undue restriction of available credit for more productive uses, undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

"(c) The Board shall issue such rules and regulations as it deems necessary in order to enforce the requirements of this section.

"(d) For purposes of this section—

"(1) the term 'commercial bank' means any national bank and any State bank; and

"(2) the term 'State bank' shall have the same meaning given such term in section 3 of the Federal Deposit Insurance Act.".

Background

The bill H.R. 6124, as amended, reinstates and strengthens the authorities provided in the Credit Control Act, which expired on June 30, 1982. Before it expired, the Act provided standby authority permitting the President to authorize the Federal Reserve Board to regulate and control any extension of credit if necessary to control inflation. Under this legislation, the President may also invoke the Act if that is necessary to reduce high levels of unemployment and to prevent or control recession. A new section of the Act gives the Federal Reserve the immediate authority, without prior action by the President, to prevent commercial bank lending for corporate takeovers involving financing over $100 million.

The Credit Control Act was enacted on December 23, 1969 (Pub. L. 91–151, Title II). The President's authority to invoke the Act terminated on June 30, 1982 under a sunset provision enacted December 8, 1980 (Section 9 of Pub. L. 96–508).

The Act was used once during its existence, when President Carter invoked the provisions on March 14, 1980 (Executive Order 12201). The Federal Reserve Board instituted a program aimed at restraining the growth of certain kinds of consumer credit and the expansion of money market mutual funds. These controls succeeded in reducing interest rates during the period controls were in effect. For example, mortgage rates fell from 16 percent in April to 12½ percent in July, and the prime rate fell from 19½ percent in April to 11 percent in July. Credit controls were phased out by President Carter during late July and early August, 1980 (Executive Order 12225).

History of the Legislation

H.R. 6124 was introduced by Chairman St Germain on April 20, 1982. The legislation as introduced repealed the section in the Act that specified a June 30, 1982 termination date for the authority contained in the Act. The bill also authorized the President to invoke the Act to reduce high levels of unemployment and to prevent or control recession, in addition to controlling inflation. Finally, the bill as introduced gave the Federal Reserve Board the explicit authority, when the Act is invoked, to limit the use of credit for-productive purposes, including corporate takeovers, and to ensure the availability of credit for productive purposes.

The Subcommittee on Consumer Affairs and Coinage held hearings on the legislation on July 14, 15, and 16, 1982. On July 14, testimony was taken from the Honorable James Weaver, a Congressman from Oregon; from investment banker J. Morton Davis, President, D. H. Blair Company; Ruth Kobell, National Farmers Union; J. C. Turner, General President, International Union of Operating Engineers; Henry Schechter, Director, Office of Housing and Monetary Policy, AFL–CIO; Shelton Friedman, Research Director, United Auto Workers; South Dakota State Senator Doris Miner; Timothy Sheehan, President, Peerless Federal Savings and Loan Association, representing the United States League of Savings Associations; and David Stahl, Executive Vice President, National Association of Home Builders. Further testimony was heard on July 15 from Dr. Manuel H. Johnson, Acting Assistant Secretary for Economic Policy, Department of the Treasury; Preston Martin, Vice Chairman, Federal Reserve Board and Frederick Schultz, former Vice Chairman, Federal Reserve Board.

On July 16 testimony was taken from Pofessor David I. Meiselman on behalf of the United States Chamber of Commerce; Robert A. Mooney, Manager of Corporate Economics, J. C. Penney Company, on behalf of the National Retail Merchants Association and the American Retail Federation; Robert J. Genetski, Vice President and Economist, Harris Trust Bank, representing the American Bankers Association; Dr. Thomas A. Durkin, Director of Research and Education, National Consumer Finance Association; Drew V. Tidwell, General Counsel and Secretary, Consumer Bankers Association; and Nancy Z. Spillman, Los Angeles Trade Technical College.

On July 19, 1982, the Subcommittee on Consumer Affairs and Coinage met and ordered reported to the Full Committee H.R. 6124 by a vote of 6–3. The Full Committee met on August 10, 1982, in executive session to mark up H.R. 6124. The Committee rejected a motion to table the bill offered by Mr. Stanton by a vote of 21–22. The Committee adopted an amendment offered by Mr. Schumer by a vote of 23–4 which would authorize the Federal Reserve Board to require commercial banks providing financing in excess of $100 million for corporate acquisitions or mergers to notify the Federal Reserve in advance of extending such credit. The amendment also gives the Board the right to disapprove the financing if the corporate acquisiton or merger cannot be reasonably expected to produce benefits to the public that outweigh possible adverse factors.

The Committee rejected, by a vote of 18–24, an amendment in the nature of a substitute offered by Mr. Leach that in substance was similar to Mr. Schumer's amendment but which would have served as a replacement for the Credit Control Act rather than as an addition to the authority of that Act.

The Full Committee met on August 11, 1982 and ordered the bill, as amended, reported favorably by a vote of 24–18.

Summary of the Legislation

As ordered reported by the Banking Committee, H.R. 6124 repeals the provision in the Credit Control Act that terminated the authority

under the Act as of June 30, 1982. The bill expands the circumstances under which the President may invoke the Credit Control Act to include situations involving the need to reduce high levels of unemployment in any sector of the economy and to prevent or control recession, in addition to the need to fight inflation. The bill also gives the Federal Reserve the explicit power under the Credit Control Act to limit the use of credit for non-productive purposes, including corporate takeovers, and to take steps to ensure the availability of credit for productive and necessary purposes.

Finally, the bill authorizes the Federal Reserve Board to require commercial banks which plan to assist in the financing of any corporate acquisition or merger that involves more than $100 million in financing to notify the Board of such proposed financing. The Board could disapprove the financing if the acquisition or merger involved would not produce benefits to the public outweighing possible adverse effects. The Federal Reserve Board may exercise this authority regardless of whether the President has made the determination prescribed in Section 205(a) of the Act.

Need for the Legislation

America today faces the worst economic crisis since the Depression. Unemployment is at record levels, and the national unemployment rate is 9.8 percent. Among selected industries the rate is even higher. For example, unemployment is 18.8 percent among construction workers, and 25 percent in the automobile industry. In Portland, Oregon, 61 percent of the heavy equipment operators are out of work, while in Rochester, New York, the rate among heavy equipment operators is 85 percent.

The housing industry is having its worst year since 1946. Housing starts are at a virtual trickle, while mortgage interest rates remain high. Today's mortgage rates of 17 percent mean that a $50,000 mortgage will cost a homeowner over a quarter of a million dollars in payments over 30 years. The rates are so prohibitively high that the overwhelming majority of all Americans cannot qualify for home mortgages.

The high interest rates that have decimated the housing industry have had a "trickle-down" effect on related industries. Representative Jim Weaver of Oregon, Chairman of the Forests, Family Farms and Energy Subcommittee of the House Agriculture Committee, told the Banking Committee's Subcommittee on Consumer Affairs and Coinage of the effect on the lumber industry.

> The plain fact is that the housing crunch has destroyed the forest products industry—lumber and plywood production are way down and unemployment is skyrocketing.
>
> For the week ending June 26, 200 Western sawmills were closed and 154 were working reduced production schedules. In the previous week 172 mills were closed. This means that 47 percent of Western sawmill capacity is now closed or curtailed. These reductions have led to layoffs or reduced hours for 48,100 employees. In the South the situation is much the same. For the week ending June 26, 174 mills were closed and

127 were working curtailed schedules, affecting 24,700 employees: 46 percent of Southern capacity.

In my home State of Oregon, 24,000 fewer people were employed in the lumber and wood products industry in May 1982 than were employed in May 1978. In construction, 20,000 less persons were employed in May compared to May 1979. Two counties in my own district—Curry and Douglas—have unemployment rates of 17.5 percent and 17.3 percent respectively, while four other counties have unemployment rates over 12 percent.

High interest rates have taken their toll on consumers and businesses alike. Business bankruptcies are running 15 percent ahead of their pace last year. Every seven minutes another business goes bankrupt. In 1981 460,000 consumers filed for bankruptcy, and an equal number are likely this year. Every 69 seconds another consumer files for bankruptcy.

The automobile industry is also in serious trouble. Sales during the first ten days of August were down 27 percent over the same period last year. Two hundred sixty thousand workers have lost their jobs. Countless plants have been closed for weeks and months on end, other plants have closed their doors for good.

American agriculture has also suffered considerably from high interest rates. The effect of high interest rates on farmers shows up in agriculturally dependent businesses as well. In South Dakota, first quarter 1982 sales of farm machinery were down 27 percent from the same period in 1981.

South Dakota State Senator Doris Miner, who has owned a sheep and cattle ranch for almost 30 years with her husband, told the Consumer Affairs and Coinage Subcommittee how in her hometown a shoe store, car dealership, and farm implement dealer have gone out of business in the past six months. She told how neighboring farmers were forced into bankruptcy and lost their farms due to high interest rates.

Amidst the difficulties that consumers and small businesses have had qualifying for, or being able to afford credit, one anomaly stands out. Giant corporations have been able to obtain multi-billion dollar lines of credit to finance the acquisition of other giant corporations. In 1981 over $70 billion in lines of credit were made available to corporations in takeover efforts. The five largest lines of credit and the lead banks involved are shown in the following chart.

Company and lead bank	*Line of credit (billions)*
Mobil, Citibank	$6.0
Texaco, Chase Manhattan	5.5
Gulf, Bankers Trust	5.0
Marathon, Chase Manhattan	5.0
Cities Service, Morgan Guaranty	4.0

As J. C. Turner, General President of the International Union of Operating Engineers testified before the Subcommittee on Consumer Affairs and Coinage:

> These merger loans and lines of credit for these nonproductive investments squeeze out productive users of credit such as industry, housing, farmers, utilities, and State and local governments. Why, we ask, should corporations like U.S.

> Steel, DuPont, Mobil and Fluor tie up money that could better have gone for industry investment, or home mortgage loans? "Tilting" available credit away from non-productive uses and toward productive investments will have the effect of increasing the available supply of capital and lowering interest rates for productive uses of credit.

The new section of the Credit Control Act that the Committee adopted is designed to deal with this immediate problem, without Presidential action. As noted, it gives the Federal Reserve authority right now to deal with the waves of credit diverted to pointless corporate takeovers. If necessary, the bill gives the President and the Federal Reserve broader standby authority to regulate corporate takeovers and assure that credit is used in productive ways.

As the Honorable Timothy Sheenhan, a former Member of the House, testified:

> Almost everyone would agree that "military preparedness" is a responsibility of the government, even during peacetime. We believe that "economic preparedness" is similarly an appropriate concept. To maintain "economic preparedness" weapons such as the Credit Control Act belong in our national policy arsenal.

On the question of the 1980 experience with credit controls, J. C. Turner of the Operating Engineers testified:

> Our Nation's one experience with credit controls under the 1969 Act—for a brief period in the spring of 1980—indicates that they can work to bring interest rates down dramatically: in a matter of weeks after the imposition of controls the prime interest rate fell from 20 percent to 12 percent, and the decline in home construction and overall economic activity was actually reversed. I think we also learned some lessons from that experience about how not to apply selective credit regulations, particularly in squeezing out consumer credit on what became in some cases a retroactive basis.

Henry Schechter, Director of the Office of Housing and Monetary Policy of the AFL–CIO, offered this analysis of the 1980 experience:

> Credit controls, introduced for about a three-month period in 1980, under authority of the Credit Control Act of 1969, were helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started two months before the March 14, 1980 date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.
>
> The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. After credit controls were

> instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,550,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up. The modest use of credit control authority led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

The New York Times, in a July 17, 1982 editorial, evaluated the 1980 controls in this way:

> The controls had a powerful psychological effect. They restrained borrowing, drove down interest rates and slowed down economic activity. Only afterwards did economic observers decide that the controls worked too well. The recession apparently had already begun and this new restraint merely made it worse.

The Times went on to conclude that, notwithstanding the criticism of the 1980 experience from some observers,

> [Standby control powers] could be a useful supplement to monetary policy when the economy becomes overheated. The controls, which could not be safely requested in the middle of a crisis, would assure the flow of funds to productive sectors of the economy and thus help to restrain interest rates. * * *
>
> It seems foolhardy to deny the Government standby powers for emergencies on the ground that they once were wrongly applied.

H.R. 6124 reinstates the Credit Control Act by removing the June 30, 1982 sunset date from the Act. From 1969, when the Credit Control Act was signed into law, until 1980, the Act had no sunset date and was, in effect, permanent standby authority for the President. The bill, therefore, would return the Act to the status it had before the sunset date was added in 1980.

The bill also expands the President's powers under the Act to provide him with a standby tool that he can use to fight the high interest rates that have taken such a heavy toll on the nation. The President can use the Act to assure that credit is directed to those sectors of the economy that are most in need of assistance and that are most harmed by continuing high interest rates. The Act also gives the Federal Reserve the power to direct credit to those areas of the economy that contribute the most to the nation's well-being and away from those areas that contribute nothing to gains in productivity.

The powers of the Credit Control Act are standby powers. Nothing in the Act requires the President to invoke it. The Act does, however, provide the President with a power than can be invoked very quickly should the need arise.

H.R. 6124 expands the Act, permitting its invocation not only to

fight inflation, but also to reduce unemployment in any sector of the economy and to prevent or control recession. This expansion permits the Act to be used selectively to aid particular segments of the economy that are hard hit by high interest rates or other factors in the credit markets. In addition, it permits the President to use the Act during times of economic recession regardless of whether inflation rates are high. Recent events have shown that declines in the rate of inflation can be accompanied by devastatingly high unemployment and recession.

The Committee found that the large amounts of credit absorbed by corporate mergers could have adverse affects on the nation's economic well-being as a whole. For that reason, the Committee adopted an amendment offered by Mr. Schumer to provide the Federal Reserve Board with the authority to require that proposed credit commitments in excess of $100 million for corporate merger or acquisitions, be reported by commercial banks to the Board. Under the amendment, the Federal Reserve could disapprove such proposed financing should it determine that the potential benefits of the merger, such as increased employment and competition and gains in efficiency, outweigh the possible adverse effects, such as undue restrictions of available credit for more productive purposes, undue concentration of resources, decreased or unfair competition, conflicts of interest and unsound banking practices. The Federal Reserve Board may exercise this authority under the Act without regard to whether the President has made the determination under Section 205(a) of the Act.

The Committee concludes that enactment of the bill will provide the President with the necessary standby authority, should it be necessary to help the nation recover from its current economic troubles.

For these reasons the Committee concludes that enactment of this bill is necessary and recommends that the House pass H.R. 6124 as amended.

Statements Made in Accordance With House Rules

In accordance with clauses 2(l)(2)(B), 2(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made.

Committee Vote (Rule XI, Clause 2(l)(2)(B))

H.R. 6124, as amended, was ordered reported favorably by a vote of 24 votes in favor of reporting favorably and 18 votes against reporting the bill.

The following committee members cast votes for reporting favorably the bill H.R. 6124, as amended: St Germain, Reuss, Gonzalez, Minish, Annunzio, Mitchell, Fauntroy (by proxy), Patterson, Blanchard (by proxy), LaFalce, Evans (Ind.), D'Amours, Lundine, Oakar, Mattox, Vento, Garcia, Lowry, Schumer, Frank, Eatman, W. Coyne, Hover, and McKinney.

The following committee members cast votes against reporting the bill: Neal, Stanton (by proxy), Wylie (by proxy), Hansen (by proxy), Evans (Del.) (by proxy), Paul (by proxy), Bethune (by proxy), Shumway (by proxy), Parris (by proxy), Weber (by proxy),

McCollum (by proxy), Carman (by proxy), Wortley (by proxy), Roukema (by proxy), Lowery (by proxy), J. Coyne (by proxy), Bereuter (by proxy), and Dreier (by proxy).

The following committee members were absent and did not vote: Hubbard, Barnard, and Leach.

OVERSIGHT FINDINGS AND RECOMMENDATIONS (RULE XI, CLAUSES 2(l)(3)(A) AND (D), AND RULE X, CLAUSES 2(b)(1) AND (2) AND 4(c)(2))

The Subcommittee on Consumer Affairs and Coinage held hearings on July 14, 15, and 16, 1982, on H.R. 6124. The hearings involved detailed discussions on the advantages and disadvantages of reauthorization of credit control legislation. The Subcommittee also heard testimony on the effect that high interest rates and the current depressed economic situation are having on consumers, farmers, businesses, financial institutions, the automobile industry and the construction industry. The Committee finds that a reinstatement of the Credit Control Act, a broadening of the situations in which it can be invoked, and changes to permit more control to exist over the financing of unproductive corporate mergers is necessary. Therefore, the Committee recommends that the House pass the bill H.R. 6124, as amended and ordered reported by the Committee.

No formal oversight findings or recommendations have been submitted by the Committee on Government Operations.

COST ESTIMATE OF THE CONGRESSIONAL BUDGET OFFICE PURSUANT TO SECTION 403 OF THE CONGRESSIONAL BUDGET ACT OF 1974 (RULE XI, CLAUSE 2(l)(3)(C))

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C., August 13, 1982.

Hon. FERNAND J. ST GERMAIN,
Chairman, Committee on Banking, Finance and Urban Affairs,
U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Pursuant to Section 403 of the Congressional Budget Act of 1974, the Congressional Budget Office has reviewed H.R. 6124, a bill to reduce interest rates, control inflation, and ensure the availability of credit for productive purposes, and promote economic recovery by extending the Credit Control Act, as ordered reported by the House Committee on Banking, Finance and Urban Affairs, August 11, 1982.

H.R. 6124 would expand and make permanent the provisions of the Credit Control Act, which expired on June 30, 1982. It would allow the President under certain circumstances to authorize the Board of Governors of the Federal Reserve System to take various actions to regulate credit. Since its passage in 1969, the Act has been triggered only once, in the spring of 1980 under President Carter. The cost to the Federal Reserve Board of administering the changes required at that time were approximately $1 million, and primarily included legal staff time, as well as the cost of conducting seminars and preparing and

disseminating information regarding the new credit requirements. Because it is not possible to predict whether or not the President would invoke this authority any time in the future, it is not possible to estimate with any precision the budget impact of this section of H.R. 6124.

In addition, H.R. 6124 would require the Federal Reserve Board to review corporate mergers or acquisitions when financing by commercial banks would exceed $100 million. It would also require the Board to issue rules and regulations to enforce these provisions. Based on information provided by the Board, and assuming that no more than 100 mergers would be reviewed annually, the cost would not be likely to exceed an estimated $500,000 annually. The reviews would likely focus on acquisitions by nonfinancial institutions, and require start-up costs to develop rules and procedures for carrying out reviews, as well as devising forms, revising manuals and training examiners to conduct the reviews. Any additional cost to the Board as a result of enactment of H.R. 6124 would reduce the Board's payment of its excess revenues to the Treasury.

Should the Committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

RAYMOND C. SCHEPPACH
(For Alice M. Rivlin, Director).

INFLATION IMPACT STATEMENT (RULE XI, CLAUSE 2(l)(4))

The Committee believes that H.R. 6124 as amended and ordered reported by the Banking Committee will have no inflationary impact.

SECTION-BY-SECTION ANALYSIS

Section 1 repeals the sunset provision in the Act that terminated the authority under the Act as of June 30, 1982.

Section 2(a) expands the authority of the President by permitting him to invoke the Act in order to reduce high levels of unemployment in any sector of the economy and to prevent or control recession, in addition to the authority in the original Credit Control Act to deal with inflation.

Section 2(b) adds to the enumerated list of Federal Reserve Board authorities under the Act the authority to prescribe appropriate limitations relating to credit for nonproductive purposes such as corporate takeovers, and to ensure the availability of credit for productive and necessary purposes.

Section 3 adds a new section to the Act authorizing the Federal Reserve to require any commercial bank planning on assisting in corporate merger or acquisition financing involving more than $100 million in financing to notify the Board in advance of the proposed financing. The Board is given the authority to disapprove any such proposed financing if it determines that there is no reasonable expectation that the merger or acquisition would produce benefits to the public, such as increased employment, increased competition or gains in efficiency, that outweigh possible adverse effects, such as undue restriction of available credit for more productive purposes, undue concen-

tration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. This authority of the Federal Reserve does not require Presidential action under Section 205(a) of the Act before taking effect. The Board is directed to issue any regulations needed to carry out these requirements.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

CREDIT CONTROL ACT

* * * * * * *

TITLE II—AUTHORITY FOR CREDIT CONTROL

* * * * * * *

Sec. 205. Authority for institution of credit controls

[(a) Whenever the President determines that such action is necessary or appropriate for the purpose of preventing of controlling inflation generated by the extension of credit in an excessive volume, the President may authorize the Board to regulate and control any or all extensions of credit.]

(a) Whenever the President determines that such action is necessary or appropriate to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession, the President may authorize the Board to regulate and control any or all extensions of credit.

* * * * * * *

Sec. 206. Extent of control

The Board, upon being authorized by the President under section 205 and for such period of time as he may determine, may by regulation

(1) require transactions or persons or classes of either to be registered or licensed.

(2) prescribe appropriate limitations, terms, and conditions for any such registration or license.

(3) provide for suspension of any such registration or license for violation of any provision thereof or of any regulation, rule, or order prescribed under this Act.

(4) prescribe appropriate requirements as to the keeping of records and as to the form, contents, or substantive provisions of contracts, liens, or any relevant documents.

(5) prohibit solictations by creditors which would encourage evasion or avoidance of the requirements of any regulation, license, or registration under this Act.

(6) prescribe the maximum amount of credit which may be extended on, or in connection with, any loan, purchase, or other extensions of credit.

(7) prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes.

[(7)] *(8)* prescribe the maximum rate of interest, maximum maturity, minimum period payment, maximum period between payments, and any other specification or limitation of the terms and conditions of any extension of credit.

[(8)] *(9)* prescribe the methods of determining purchase prices or market values or other bases for computing permissible extensions of credit or required downpayment.

[(9)] *(10)* prescribe special or different terms, conditions, or exemptions with respect to new or used goods, minimum original cash payments, temporary credits which are merely incidental to cash purchases, payment or deposits usable to liquidate credits, and other adjustments or special situations.

[(10)] *(11)* prescribe maximum ratios, applicable to any class of either creditors or borrowers or both, of loans of one or more types or of all types

(A) to deposits of one or more types or of all types.

(B) to assets of one or more types or of all types.

[(11)] *(12)* prohibit or limit any extensions of credit under any circumstances the Board deems appropriate.

* * * * * * *

[Sec. 211. Termination

[The authority conferred by this title expires at the close of June 30, 1982.]

Sec. 211. Review of financing for corporate acquisitions on mergers

(a) Without regard to the procedures specified in section 205(a) of this title, the Board is authorized to require any commercial bank which plans to assist in the financing of any part of a corporate acquisition or merger involving more than $100,000,000 in financing to notify the Board of such proposed financing before a line of credit is extended by such commercial bank.

(b) The Board may disapprove any proposed financing if the Board determines that the corporate acquisition or merger involved cannot reasonably be expected to produce benefits to the public, such as increased employment, increased competition, or gains in efficiency, which outweigh possible adverse effects, such as the undue restriction of available credit for more productive uses, undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

(c) The Board shall issue such rules and regulations as it deems necessary in order to enforce the requirements of this section.

(d) For purposes of this section—

(1) the term "commercial bank" means any national bank and any State bank; and

(2) the term "State bank" shall have the same meaning given such term in section 3 of the Federal Deposit Insurance Act.

MINORITY VIEWS ON H.R. 6124 (CREDIT CONTROL ACT EXTENSION)

INTRODUCTION

The proposed credit control legislation even if passed and never invoked is harmful. Moreover, if passed and invoked, the legislation will not achieve the intended objectives—lowering of interest rates, abatement of stagflation, and the restoration of a more prosperous economy. The basic reason is that it addresses symptoms and that it fails, as it does, to attack the underlying causes: An excessive creation of money and credit over the years. On the contrary, it is likely to prolong the agony and inflict untold harm on the economy by burdening it by oppressive regulation and reporting requirements, by creating uncertainty and distortions, and by politicizing the most efficient markets we have, the financial markets. The true answer is obvious, it consists in the resolute and persevering application of sound fiscal and monetary policies. There is nothing in the proposed legislation which proposes any novel or better ideas, other than the selfsame nostrums that served us so badly in 1980. Although we may differ on specific points, we are united on the fundamental policies stated in these views.

Dictatorial Powers Conferred by the Act and its Amendments

The authority conferred upon the Federal Reserve is breathtakingly broad. Under the Act the President may authorize the Federal Reserve Board to regulate "any and all" extensions of credit whenever such action is believed ". . . necessary or appropriate to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession . . ." Once authorized by the President, the Federal Reserve may regulate the terms of credit contracts including down payments, maturities and interest rates; prescribe licensing of borrowers and record-keeping requirements; determine the methods of calculating purchase prices or market values of new and used goods to be financed by credit; and prescribe or modify the terms of such contracts among natural persons and corporate entities; prescribe maximum loan-to-deposit or loan-to-asset ratios for creditors and debtors; and prescribe limits with respect to credit for non-productive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes.

The Act was further modified in Committee by Mr. Schumer's amendment which requires that the financing for any merger involving $100 million or more in financing be approved by the Federal Reserve Board taking into account the "benefits to the public, such as increased employment, increased competition, or gains in efficiency, which outweigh possible adverse effects, such as the undue restriction of available credit for more productive uses, decreased or unfair competition, conflicts of interest, or unsound banking practices." This amendment,

which was derived from an amendment in the nature of a substitute to H.R. 6124, offered by our colleague, Jim Leach, in the opinion of the General Counsel of the Federal Reserve is not contingent on Presidential invocation but becomes effective if and when H.R. 6124 becomes law.

The regulatory scope of the original Act, therefore would be broadened by these amendments even beyond the far-flung boundaries drawn by the framers of the original legislation. In sum, the Federal Reserve not only may establish interest rate ceilings and modify contracts among individuals and corporate persons, it is also enjoined to ensure that "productive" businesses—a term otherwise undefined—get their share of the available credit. On the basis of what principles the allocation of credit is to take place is unclear, but apparently it is not to be the collective judgment of the credit markets as expressed in interest rates, since these too, are subject to regulation. The Schumer amendment means that, in addition to the review by the Department of Justice and/or the Federal Trade Commission, the financing for business consolidations, acquisitions, and mergers now would be subject to review also by the Federal Reserve for a judgment of public economic benefit, however defined.

Congress Passes the Buck to the Prime Target of Its Economic Criticism: the Federal Reserve

When contemplating the vast powers which would be conferred on the Federal Reserve, one is struck by the anomaly that Members of Congress are willing to annoint the Federal Reserve Chairman as economic Czar of this country whose competence on other occasions they have attacked so savagely.

Criticism of the Federal Reserve continued with Chairman St Germain during the July 1982 hearings on the conduct of monetary policy:

> I have the greatest respect for the current Chairman of the Federal Reserve . . . However, the Nation is not happy with the results of the economic policies of either the Federal Reserve or the Administration, good intentions notwithstanding.

And former House Banking Committee Chairman Henry Reuss greeted the Federal Reserve Chairman in these words:

> I welcome my friend Paul Volcker, but I do have to express my unhappiness at the Federal Reserve Open Market Committee.

Congressman Annunzio, Chairman of the House Subcommittee on Consumer Affairs and Coinage, opened his Subcommittee's hearings on the Credit Control Act with these words:

> I think the controls could have been even more effective had the Federal Reserve Board not established regulations for the controls that were confused, hard to implement, and in most cases totally unworkable. These Rube Goldberg regulations made even supporters of credit controls, such as myself, express concern about the regulations.

During the February 1982 hearings on the conduct of monetary policy, Congressman Gonzalez, for example, had this to say:

> * * * Chairman Volker, I think it impelling on my part to report to you that the fears, I am sure, that have obsessed you should be allayed with respect to my impeachment resolution. I had a letter from Chairman Rodino in which he indicates that he can't proceed on that for the immediate future * * * However, I intend to proceed in absentia on the House floor. My question is: If President Reagan is right and if you are so right, why is the stock market in such a state of collapse, why is the stock market in such a state of hysteria? Why are the bond markets collapsed? Why is investment down? Where is all the confidence and growth that was supposed to come out of "Volckernomics"? The results have so far been re-Volckering.

Thus, it is highly ironic that many of the same members who are so vocal in condemning Federal Reserve policy, now want to make the Federal Reserve the supreme arbiter of all credit in this country. Mr. Stanton disposed of this issue to our satisfaction in his opening statement at the Committee's markup.

> * * * Just let me state that the Federal Reserve does not want this additional power, and the Administration does not believe that the Federal Reserve needs what amounts to unlimited and unchecked authority. This legislation amounts to the Congressional buck-passing at its finest.

The Unfortunate Lessons of 1980 Experience

The efforts of the Majority to revive the Credit Control Act would be easier to understand if we had not been around this track once before. But there is a history and there is experience which drew the following comments from witnesses who had opportunity to study the results at close range. Former Vice-Chairman of the Federal Reserve Board Frederick Schultz, the administrator of credit controls at the time, summarized his conclusions in these words:

> Perhaps the most important thing we learned from the 1980 experience is that credit controls do not solve the underlying problem of an economy. We still found ourselves at the end of 1980 with the need to deal with inflation, high interest rates, and languishing productivity.

And the current Federal Reserve Board Vice-Chairman, Preston Martin, noted:

> In the end credit controls added to the volatility in financial markets and the economy in 1980. By distorting the underlying economic and financial conditions, sound fiscal and monetary policies were more difficult to formulate and sustain.

And Manuel Johnson, Assistant Secretary for Economic Policy, U.S. Treasury Department, elaborated:

> The recent experience with credit controls in 1980 exemplifies virtually all of the undesirable consequences of controls. Instead of reducing inflation, providing more efficient

allocation of credit, and strengthening the economy—objectives that proponents claim will be achieved by controls and are established as goals in H.R. 6124—the results were generally just the opposite. Key industries targeted for relief, such as housing and autos, collapsed under the weight of credit scarcity. Interest rates were temporarily reduced, but the cutoff of credit at the lower rates produced rising unemployment and a general weakening of the economy that subsequently turned into a full scale recession from which we still have not fully recovered. And, instead of declining, inflation continued strong throughout the year.

Trade associations, representing large segments of the U.S. economy, such as the American Bankers Association observed:

> It is clear that the imposition of credit controls in March 1980 exacerbated an already declining economy, pushing it into an unnecessary violent contraction * * *
>
> No bureaucracy, no matter how well intentioned, should be empowered to substitute their decisions for the millions of private economic decisions made daily by the American public.

The National Association of Realtors stated categorically:

> We are unimpressed by the general usefulness of economic controls imposed under both a Republican Administration (Nixon) and a Democratic Administration (Carter). We are fearful, in particular, that credit controls, if used, would work to the disadvantage of American homeowners.

Last year the National Retired Teachers Association and the American Association of Retired Persons told the Domestic Monetary Policy Subcommittee:

> Credit control selectively channels money away from or toward specified activities and is often linked with state planning of the use of credit * * *
>
> We know of no good reason to revive credit controls as a tool of monetary policy . . . The tools we already have for the control of the money supply are ample to control money and credit if they are used in accordance with a consistent policy of restraint.

Similarly, the Independent Bankers Association of America warned our Committee:

> We remain unconvinced that mandatory credit allocation is either a proper or effective response to these conditions. Further, we believe that the granting of such broad and unfettered powers to any independent agency of government, such as would be accomplished by H.R. 6124, constitutes a public policy so lacking in prudent limitations as to court catastrophe.

And the Motor Vehicle Manufacturers Association contended:

> As a direct result of this (the 1980) experience * * * we believe that the use of the authorities in the Credit Control

Act of 1969, which would be renewed in H.R. 6124 are interventionist in formulation, have proven to be counterproductive in execution and could be potentially threatening to the economic recovery which is just now beginning.

In addition, credit controls are opposed by the following organizations: the National Federation of Independent Business; the Credit Union National Association; the U.S. Chamber of Commerce; Sears, Roebuck and Company; the American Retail Federation; the National Retail Merchants Association; the Investment Company Institute; the National Consumer Finance Association; the J. C. Penney Company; and the Federal Home Loan Bank Board.

To supplement the qualitative conclusions of these expert witnesses here are some of the quantifiable results of that unfortunate 1980 experiment:

Over 1.5 million jobs were lost. Total unemployment rose 1.5 percentage points, while unemployment for blacks and other minorities rose by 2 full percentage points. Unemployment is too high today—such controls could only make a bad situation worse.

Real economic growth as measured by GNP fell by almost 10 full percentage points, the greatest decline for a single quarter since World War II and stands in distinct contrast to the positive GNP growth during the remaining quarters of 1980.

The 1980 credit controls had no lasting effect on either inflation or interest rates. The temporary relief from high interest rates was brief, and rates climbed to even higher rates than before the controls were implemented.

Industries favored under the 1980 guidelines—such as farmers, homebuilders, and the auto industry—failed to benefit. Controls exacerbated the declining trends in these sectors, and only when the controls began to be removed did these sectors show an upward trend.

Although homebuyers were favored, the number of new private housing units authorized dropped by over 370,000 (annual rate) between February and April and returned to a more normal 1.2 million (annual rate) only in July 1980 when credit controls had stepwise been removed.

Retail passenger car purchases declined from 10.8 million (annual rate) in February, the last full precontrol month, to 7.2 million (annual rate) in May, or a loss of 3.6 million cars within a span of 3 months.

Farmers were supposed to be favored, yet farm income collapsed to $16.9 billion net in the second quarter from $23.4 billion in the first quarter and recovered gradually only after the lifting of the credit controls.

Small business—typified by retail merchants and another purported beneficiary of credit controls—suffered disastrously. Failures rose from 291 in February of 1980 to a peak of 492 in July of that year. And the failure rate for all business rose from 27.5 per 10,000 firms in February to a peak of 52.0 per 10,000 firms (seasonally adjusted rate) in July.

Additional Evidence Against Credit Controls

In an opening statement to the credit control hearings held by his Consumer Affairs Subcommittee, Chairman Annunzio suggested that

the Federal Reserve had put forth less than its best efforts in implementing the credit controls when they were invoked by President Carter in March of 1980:

> * * * If the Fed had deliberately and completely tried to sabotage the credit controls, I don't think they could have done a more effective job than the regulations they issued.

While some might discount this statement, it does raise the question about how conclusive the 1980 experience was. Those who feel that a more inspired implementation of the Act would have ensured or would in the future ensure the objectives of this legislation, may be convinced of their error by the following considerations.

1. The whole concept of the Credit Control Act and its amendments is flawed.—Inflation, high interest rates, and stagflation are the result of faulty macro-economic policies, i.e., excessive money and credit creation in the past followed by half-hearted measures to deal with the ensuing bouts of inflation. Repeated failure to deal with these problems resolutely and effectively has created widespread skepticism about the authorities' steadfastness of purpose. The solution to the problem of high interest rates and inflation must necessarily address the causes that brought them about. This the Credit Control Act fails to do. As Professor Meiselman, speaking for the U.S. Chamber of Commerce, noted:

> To achieve lower interest rates in general requires a reversal of some or all of the factors that have made the complex of interest rates high in the first place. Standing on the top of Capitol Hill and shouting at the financial markets or ordering interest rates to fall will no more succeed than did King Canute who tried to bark orders at the ocean tides.

2. The objectives of the credit controls legislation are inherently contradictory.—Federal Reserve Vice-Chairman Schultz observed during the hearings:

> Certainly one does not lower interest rates by reducing credit supplies. So the lowering of interest rates must be achieved by reducing effective credit demands which in the aggregate is not consistent with higher rates of spending and economic activity (which is an avowed major aim of the proposed legislation).

3. The proposed legislation is flawed also because it is premised on the erroneous assumption that credit availability is a zero-sum game.—Credit denied one class of borrower, however, does not become available to others. Dr. Robert Genetski, speaking for the American Bankers Association, noted:

> There is an error in assuming that just because we prevent one billion dollars in loans to acquire a particular company, that there will be an additional one billion dollars available for new homes, new autos, new plants and equipment. This is just not so.

The fact is that the credit total contracts and expands over time depending on a host of circumstances, such as the liquidity of the banking system, reserve requirements, foreign and domestic interest rates,

etc. Moreover, loans are granted on their individual merits on a case by-case basis.

4. The framers of the Credit Control Act have been unable to furnish the Federal Reserve a set of criteria for the distinction between "productive" and "unproductive" loans.—In respect to the latter type, they were able to come up with only one example—corporate takeovers. However, even these are subject to exceptions, for example, in the case of mergers between and among thrifts, although, again no criteria are provided for distinguishing among permissible and impermissile mergers. In any event, the notion that mergers involving large companies preempt credit availability for other purposes is in error because drawdowns of loan commitments for the purposes of financing mergers are recycled into the banking system and thus returned to the flow of funds available for investment and consumption.

5. Enforcement would lead to evasion and ever-growing controls and eventually would subvert the market system.—Denial of credit for certain purposes, as intended by the proposed Credit Control Act, moreover is likely to give rise to evasion and "shadow" rates of interest. Since money and credit are fungible, companies may finance projects that are officially discouraged by shifting funds and replacing them with credit obtained for projects that are allowed or even encouraged by the administrators of the control system. Large multinationals that can readily draw on the large Eurocurrency market are particularly well situated to play this game. And as Vice-Chairman Schultz pointed out during his testimony:

> There is simply no way that all of the credit channels—domestic and international—can be controlled, certainly not without a mechanism that is totally subversive of our basic market system.

The allocation of credit to government-favored lines of business creates other difficulties. If Federal Reserve Board regulators prescribe below market ceiling rates at which funds are to be lent to designated firms or lines of business, such credit lines are apt to be scarce if they do not dry up completely. Banks will seek more profitable uses for their funds. If availability of credit is prescribed by government for favored classes of credit users, they are likely to carry the market rate of interest—and for that no credit controls are needed. Attempts by government regulators to prescribe simultaneously both the amounts of loans and their rates of interest will be viewed by the affected institutions as confiscatory and meet extreme resistance including legal action. And in any event, experience has shown that its enforcement cannot be compelled without ever tighter controls which ultimately destroy an efficient market system.

Compliance depends on the voluntary cooperation of the financial institutions and business enterprises affected. But for voluntary cooperation the sanctions provided by the Act are not needed and may well be counterproductive.

6. The very existence of credit control legislation is harmful.—Some people argue that prudence calls for the passage of credit control legislation as a standby measure in case of emergency. Even granting for argument's sake that the credit controls have some value in emergency situation—a proposition which we emphatically deny—the fact re-

mains that the very existence of such legislation on the statute books is harmful and self-defeating.

Former Federal Reserve Vice-Chairman Frederick Schultz perceptively related the existence of credit control statute to the political process:

> The quick-fix or band-aid policy always looks attractive but it is a cruel deception. This is why I oppose having credit controls available even on a standby basis for emergency situations. It is too tempting to take such a tool off the shelf when the alternative is the sustained use—over a period longer than an election cycle—of policy instruments that attack the fundamental sources of our difficulties.

Other witnesses have called attention to the impact of such legislation on the expectations of the financial community and the defensive steps taken by its members.

Assistant Treasury Secretary Johnson, recalling the 1980 experience, made this observation:

> As credit market participants heard frequent rumors that credit controls would be invoked, in spite of administration denials, there was a massive anticipatory borrowing that drove interest rates sharply higher. The 32 percent growth in short term business credit for the three months ending in March 1980 is the highest three month rate ever recorded for this type of borrowing.

CONCLUSION

In summary, the very act of conducting hearings and framing legislation designed to impose credit controls contributes to higher than necessary interest rates. The obvious reason is that these widely reported proceedings—especially in conjunction with persistent efforts to force the hand of the Federal Reserve to accelerate money growth beyond established targets—are bound to unsettle the financial markets. Thus, efforts to revive credit control legislation—even on a standby basis—defeat their purported objective—the further reduction of interest rates.

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